

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 311

August 25, 1966

TRUSTS: DEDUCTION FOR DISTRIBUTIONS TO BENEFICIARY

Syllabus:

It was ruled in Legal Ruling 304 that the trust considered therein was not entitled to a deduction for the income distributed to the beneficiary for the reason that the distributions were deemed to be in contravention of the provisions of the trust instrument. As stated in the ruling, however, the trust instrument conferred upon the trustee an absolute and uncontrolled discretion to expend and apply for the benefit of the beneficiary so much of the net income deemed necessary and reasonable for the beneficiary's maintenance and education. No part of the income distributed was actually used for the maintenance and education of the beneficiary.

Section 17761 of the Personal Income Tax Law allows a complex trust a deduction for the amount of distributable net income of the trust which is "properly paid or credited or required to be distributed for such taxable year." The deductibility of the amounts distributed by the trust in question thus depends upon whether such amounts were "properly" paid.

The law is well established that the exercise by the trustee of an absolute discretion is subject to review and control by the court only if exercised fraudulently, in bad faith, or in an abuse of discretion. Ferrall Estate, 70 Cal. App. 2d 309. The presumption is that the trustee acted in good faith in exercising his discretion. Ferrall Estate, supra. Poor or unsound judgment in the exercise of an absolute discretion cannot be deemed an abuse of discretion. Neel v. Bernard, 24 Cal.2d 406; Canfield Estate, 80 Cal. App. 443.

It cannot be said in the instant case that the trustee in exercising his absolute and uncontrolled discretion in distributing the trust income acted fraudulently, in bad faith or in an abuse of discretion. The fact that the income was not actually used for the maintenance and education of the beneficiary immediately upon distribution cannot be deemed as a distribution in contravention of the provisions of the trust instrument.

It is concluded that the amounts distributed by the trust in question were properly paid to the beneficiary. Accordingly, the trust is entitled to a deduction for the amounts distributed under Section 17761.

Legal Ruling 304 is modified to the extent of the conclusion stated therein that the distributions by the trust in question were in contravention of the

provisions of the trust instrument. The rule stated therein, however, is still applicable to distributions of income by a trust in contravention of the provisions of the trust instrument.

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